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# In the
# Supreme Court of the United States

**OCTOBER TERM, 1946**

## No. 733

INTERSTATE NATURAL GAS COMPANY, INCORPORATED,
a Corporation,
*Petitioner,*

VERSUS

FEDERAL POWER COMMISSION,
LOUISIANA PUBLIC SERVICE COMMISSION,
CITY OF NEW ORLEANS, LOUISIANA, and
CITY OF BATON ROUGE, LOUISIANA,
*Respondents.*

## BRIEF OF THE STATE OF OKLAHOMA, AMICUS CURIAE

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MARCH, 1947.

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## BRIEF OF THE STATE OF OKLAHOMA, AMICUS CURIAE

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### STATEMENT OF ISSUES MATERIAL TO THIS BRIEF

The record shows that Interstate Natural Gas Company, Incorporated, owns gas wells and a gas gathering system in the Monroe gas field in Louisiana, that it is

engaged in producing, purchasing and gathering gas in that field, and that it sells and delivers a part of this gas in the Monroe field to three pipe line companies which receive the gas and transport and sell it in interstate commerce (statement by Interstate, R. II, 599-564; statement by Commission, R. II, 577-581). Pursuant to a hearing, the Federal Power Commission issued its Order 91 (R. I, 55) asserting rate regulatory jurisdiction over these sales to these three pipe line companies and directing that the rates or prices for sales of gas to these pipe line companies be reduced as directed in said order. Upon appeal to the Circuit Court of Appeals of the Fifth Circuit, that court issued its opinion and order (R. II, 910-928) denying the petition of Interstate Natural Gas Company, Incorporated, for review of the said order of the Federal Power Commission.

In its said opinion, pursuant to which its said order was issued, the Circuit Court of Appeals held that the provisions of Section 1(b) of the Natural Gas Act exempting from the provisions of the Act "the production or gathering of natural gas," do not operate to exempt from the rate regulatory jurisdiction of the Federal Power Commission prices received in the field by producers and gatherers of gas for gas sold to pipe line companies which subsequently transport and sell the gas in interstate commerce but that the said exemption applies only to the physical acts of producing and gathering gas. In the opinion the court says:

"We think petitioner's difficulties in construction and interpretation arise out of the fact that, treating unlike things as alike, it tries to read the exception with respect to production or gathering as an exception with respect to sales. There is no warrant in the Act for so doing."

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## THE INTEREST OF THE STATE

The State of Oklahoma is not interested in facts in this case which may or may not distinguish the said sales (by Interstate Natural Gas Company, Incorporated, in the Monroe field to said three pipe line companies) from sales of gas made by other producers and gatherers generally to pipe line companies which transport and sell the gas in interstate commerce. But it is vitally interested in the opinion of the Circuit Court of Appeals in this case as an authority or precedent to the effect that all sales of gas which is subsequently transported and sold in interstate commerce are sales in interstate commerce subject to the rate regulatory jurisdiction of the Federal Power Commission, whether or not such sales are made by producers and gatherers whose operations are limited to the production and gathering of such gas and are made at the termination of such producing and gathering operations.

The State is vitally interested in having this Court review the decision of the Circuit Court of Appeals of the Fifth Circuit, and either reverse the decision or so limit the decision that it will not operate as a precedent or authority to the effect that all sales of gas by producers and gatherers

of gas to pipe line companies which subsequently transport and sell such gas in interstate commerce are sales in interstate commerce and subject to the rate regulatory jurisdiction of the Federal Power Commission, even though made as an integral and necessary part of production and gathering of natural gas.

The production of crude oil and natural gas and the manufacture of products thereof constitute one of the most important industries of the State of Oklahoma and the conservation of crude oil and natural gas reserves and the prices received for crude oil, natural gas and products thereof are of paramount importance to the State and its citizens.

Jurisdiction in the Federal Power Commission to fix the prices received by all producers and gatherers for gas sold to pipe line companies which subsequently transport and sell the gas in interstate commerce would have a direct and substantial effect not only upon the prices received for such gas but also upon the conservation of all crude oil and natural gas reserves in the State, and the protection of the correlative rights of all owners of such crude oil and natural gas reserves, and upon the income of the State and its citizens.

Just as the power to tax is the power to destroy, so the power to regulate wellhead and gathering prices is the power to control production and gathering. It is therefore of utmost importance to the State of Oklahoma and its

citizens that the decision of the Circuit Court of Appeals in this case be reversed or that it be modified in such manner that it will not be authority to the effect that the Federal Power Commission has rate regulatory jurisdiction over the prices received in the field by producers and gatherers of natural gas.

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## THE CONSTRUCTION OF THE ACT

Section 1(b) of the Natural Gas Act provides:

> "The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other *use*, and to natural-gas companies engaged in such transportation or sale, but *shall not apply* to any other *transportation* or *sale of natural gas* or to the local distribution of natural gas or to the facilities used for such distribution *or to the production or gathering of natural gas.*" (Emphasis is ours.)

While it may be assumed that the production and gathering of natural gas and the sales of such gas which is subsequently transported and sold in interstate commerce so affects interstate commerce that Congress *could* have exercised control over this part of the oil and gas industry if it had chosen to do so, it is clear that Congress *did not see fit to exercise this power*. Congress by the express provisions of the excluding language of Section 1(b) of the Act and by its definition of interstate commerce positively stated that it *did not seek to* regulate or control any phase

of the industry other than transportation and sale of gas in interstate commerce. It further expressly stated that the Act should not apply to the "production or gathering of natural gas" or to "other sales."

Much has already been said in briefs before this Court and by the Court itself in regard to the significance of the phrase, "the production or gathering of natural gas,"(1) as used in Section 1(b) of the Act and, in briefs before this Court in other cases and in this case, the legislative history of the Act in respect of the use of that phrase has been reviewed. We shall not in this brief undertake extensively to discuss any of the arguments that have already been made in this connection. Suffice it to say that the State concurs with the view that the phrase, "production and gathering," excludes the sales made by production and gathering concerns to natural gas companies which subsequently transport and sell such gas in interstate commerce for the reason set forth in briefs already filed in this case.

It is the position of the State that the most compelling argument that Congress, by the exemption from the operation of the Act of "the production or gathering of natural gas," did not intend to vest in the Federal Power Commission rate regulatory jurisdiction over prices received by producers and gatherers of gas sold to pipe line companies which transport and sell the gas in interstate commerce

1. *Federal Power Commission* v. *Hope Natural Gas Company*, 320 U.S. 591, 88 L.ed. 333; *Colorado Interstate Gas Co.* v. *Federal Power Commission* and *Canadian River Gas Co.* v. *Federal Power Commission*, 324 U.S. 581, 89 L.ed. 1206; *Panhandle Eastern Pipe Line Co.* v. *Federal Power Commission*, 324 U.S. 635, 89 L.ed. 1241.

lies in circumstances which apparently have not been pointed out either to this Court or to the Circuit Court of Appeals in this case.

It is a well established rule of statutory construction that whenever the words of a statute are susceptible of more than one meaning, they should not be given a construction which will result in an absurdity or impossibility[2] and it is the opinion of the State that that is precisely the result that would flow from the construction placed upon the Natural Gas Act by the Circuit Court of Appeals in this case.

In the opinion of the State, the best possible evidence that Congress, by the exemption of "the production or gathering of natural gas" intended to exempt from the operation of the Act *the sales* by producers and gatherers as well as their physical operations is found in facts which have not been discussed, namely, (1) that the exemption from the operations of the Act of the physical acts of producing and gathering gas without exempting the sales of gas by producers and gatherers would deprive the producing States of the power to conserve their natural resources and to protect the correlative rights of owners of oil and gas and would produce an intolerable conflict of jurisdiction. (2) that any attempt to regulate the prices received by the various producers and gatherers would be a colossal undertaking for which Congress has apparently made no provision, and (3) that in the great majority of cases it would

2. *United States* v. *Katz*, 271 U.S. 354, 70 L.ed. 986.

be utterly impossible for the Federal Power Commission to fix such prices on any standard whatever other than the whim or caprice of the Commission.(3)

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**(1) The exemption from the operation of the Act of the physical acts of producing and gathering gas without exempting the sales of gas by producers and gatherers would deprive the producing States of the power to conserve their natural resources and to protect the correlative rights of owners of oil and gas and would produce an intolerable conflict of jurisdiction.**

Upon casual consideration, the decision of the Circuit Court of Appeals that Congress intended by the provisions of Section 1 (b) of the Act to leave in the producing States jurisdiction over the physical operations of producers and gatherers but at the same time vest in the Federal Power Commission rate regulatory jurisdiction over the prices received by producers and gatherers for gas sold to pipe line companies which transport and sell gas in interstate commerce may appear to have some content, but, upon more careful examination, it will be found to be a statement of an anomaly or impossibility. It is a familiar maxim that he who controls the purse strings controls all.

As we have mentioned, the production of crude oil and natural gas and the manufacture of products thereof constitute one of the most important industries in the State

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3. As we shall show in this brief, the operations of Interstate Natural Gas Company, Incorporated, involved in this case are unique in this respect, in that its gathering operations are not affected by, or a part of, the production of oil or by-products generally.

of Oklahoma. In 1943 there were in the State a total of 55,430 wells productive of crude oil and natural gas,[4] twenty-seven refineries[5] engaged in refining crude oil, and eighty-eight gasoline plants[6] processing natural gas for the extraction of natural gasoline and other products. The income to the State from taxes on production, processing and sale of these products amounts to many millions of dollars each year, and the total income to the citizens of the State from these products is, of course, far greater. The conservation of its crude oil and natural gas resources and the protection of the correlative rights of its citizens therein, is, therefore, of utmost importance to the State, and for more than thirty years the State has been engaged in such conservation and protection of correlative rights. This Court has long recognized the power and right of the States to regulate the production of crude oil and natural gas for such purposes even though the crude oil or natural gas may, immediately upon production thereof, flow into interstate commerce;[7] and Congress has long recognized this power and has enacted statutes to assist in its enforcement.[8] Certainly, there is no implication in the Natural Gas Act that Congress intended by that Act to repeal those

4. United States Department of Interior, Bureau of Mines, Mineral Year Book 1944.

5. Oil and Gas Journal, March 30, 1946, Page 254.

6. Oil and Gas Journal, April 20, 1946.

7. *Thompson* v. *Consolidated Gas Utility Corp.*, 300 U.S. 55, 81 L.ed. 510; *Champlin Refining Company* v. *Corporation Commission*, 286 U.S. 210, 76 L.ed. 1062; *Ohio Oil Company* v. *Indiana*, 177 U.S. 190, 44 L.ed. 729; Statutes.

8. Connally Act, Chapter 15A, Section 715-715m, Title 15, U.S.C.A.; Interstate Oil Compact Act, Joint Resolution, July 7, 1943, 57 Stat., Part 1, Page 383.

statutes or stifle the power of the States to conserve their oil and gas resources or to protect the correlative rights of their citizens therein. Yet, we submit that that is precisely what the decision of the Circuit Court of Appeals in this case would do!

Let us see how these powers of the State are exercised. By its statutes and through its duly constituted authority, the Oklahoma State Corporation Commission, the State imposes many limitations and obligations upon the producers and gatherers of oil and gas for that purpose. When the production of crude oil or natural gas would otherwise exceed the market demand therefor and physical waste or economic waste would result, producers are required to limit their production. All producers are required, by plugging or casing wells in specified manner, to prevent salt water and other deleterious substances from entering oil and gas producing zones. When the production of oil wells with excessive quantities of salt water or the production of oil wells with high gas-oil ratios would result in the loss of ultimate production or the injury of the properties of others, the operation of such wells is limited or prohibited. When the drilling of separate wells on too small tracts would result in excessive drilling and resultant physical or economic waste, the operators may be required to "pool" or "unitize" their tracts, or their operations may be restricted to accomplish the same results; and when the ultimate recovery of oil and gas may be increased by

unitizing leases and returning gas to producing formations, the statutes provide for such operations.

In practically every field productive of crude oil and natural gas, some or all of the "casinghead gas" or gas produced with the oil is "gathered" together through "gathering systems" to a central point or points where it is processed in one or more "natural gasoline plants" for the extraction of natural gasoline and other products, after which a part or all of the remaining "residue" gas is returned to the various leases for use in their operations and any gas not needed for that purpose is sold by the natural gasoline plant operator, usually for the account of himself and the operators from whom he receives the gas, or is sold by the producers for their own account. A tremendous volume of this "residue gas" from casinghead gas produced in Oklahoma goes into interstate commerce, and even greater volumes of such gas and similar gas from recycling operations goes into interstate commerce from other States in the Mid-Continent area.(9)

These "gathering" and processing operations are such an integral part of the operation of the leases that many of the orders and regulations made for the conservation of oil and gas reserves and the production of correlative rights

9. United States Department of Interior, Bureau of Mines, Mineral Year Book 1944. Arkansas, 3,150 oil wells and 190 gas wells; Kansas, 23,100 oil wells and 1,990 gas wells; Louisiana, 7,250 oil wells and 1,790 gas wells; Mississippi, 370 oil wells and 20 gas wells; New Mexico, 3,980 oil wells and 120 gas wells; Texas, 100,800 oil wells and 3,560 gas wells. See Mineral Year Books.

therein must be directed toward these operations as well as the mere operation of the wells.

The language of Section 1 (b) of the Natural Gas Act makes it perfectly clear that Congress did not intend to interfere with this power of the States to control the physical acts of producing and gathering gas in order to conserve oil and gas resources and to protect correlative rights therein; but the decision of the Circuit Court of Appeals in this case necessarily presupposes that this power can be exercised by the State while the Federal Power Commission at the same time has the power to regulate the prices received by the producers and gatherers for that part of the gas which goes into interstate commerce. Nothing could be farther from the truth.

The orders of the Oklahoma State Corporation Commission, or of the duly constituted regulatory body of any other State, for the conservation of crude oil and natural gas resources must, of course, be made in the light of the funds available to the oil and gas industry from the sale of those products. For example, an order requiring all wells producing oil and gas and having a gas-oil ratio in excess of a certain stated ratio to be limited in their production, or an order limiting the total production of gas in a certain field to a certain fixed volume, or a well spacing order limiting gas wells to one well to each square mile, or an order requiring all wells in a certain field to have an extra string of casing installed, might be reasonable enough with gas selling at ten cents per thousand cubic feet but un-

reasonable and confiscatory with gas selling at five cents per thousand cubic feet; and the prices which can be received from "residue gas" necessarily have an important bearing upon the reasonableness of an order which requires or necessitates that a certain field or portion of a field be "unitized" and the gas returned to the producing formation in a manner that will best conserve oil and gas resources.

The competitive prices for crude oil and natural gas necessarily gravitate to those levels sufficient to produce for the oil and gas industry funds with which to comply with such conservation orders, but, obviously, rate regulatory jurisdiction in the Federal Power Commission over prices received by producers and gatherers for gas sold to interstate pipe line companies would vest in the Federal Power Commission control over a substantial part of the funds available to producers of oil and gas for compliance with conservation orders of the State of Oklahoma and would limit, if not destroy, the power of the State to conserve its crude oil and natural gas resources and to protect the correlative rights of owners thereof.

As we mentioned in our brief *amicus curiae* in support of the petition herein for a writ of *certiorari*, the Oklahoma State Corporation Commission recently issued an order undertaking to fix the field prices for gas in the Guymon area of the Hugoton Field. Appeals from that order are now pending in the courts. In case it be suggested that the issuance of that order is in conflict with the assertions hereinafter made in regard to the impossibility of the regu-

lation of field prices for gas on any rate regulatory standard, we wish to point out that this order of the Oklahoma State Corporation Commission is not based on rate regulatory standards but is issued purely in furtherance of conservation of gas. Also, it has to do with a field in which no crude oil is produced and in which, therefore, many of the complexities of oil and gas operations which make the application of utility rate regulatory standards impossible do not exist.

It may be suggested that, since the Natural Gas Act clearly leaves to the producing States control over the physical operations of the production and gathering of natural gas and denies that control to the Federal Power Commission, the Commission, as a matter of law, would, in fixing the prices of producers and gatherers of gas, have to allow them the cost of compliance with State regulatory orders. Obviously, such an argument is untenable. Any regulatory body empowered to regulate prices or rates must, of necessity, have some power to determine the reasonableness of expenditures made by the regulated company. While there might be some presumption in favor of the reasonableness of orders made under State conservation laws, there inevitably would be a point beyond which the Federal Power Commission could challenge the reasonableness of such orders and the reasonableness of compliance therewith. Furthermore, the orders of the Federal Power Commission fixing rates or prices would necessarily be prospective in their operation and any orders by the State

would be made in the face of prices already fixed. Such a conflict of authority would be intolerable.

**(2) Any attempt to regulate the prices received by the various producers and gatherers would be a colossal undertaking for which no provision has been made.**

In the State of Oklahoma alone there are thousands of wells productive of gas and there are ighty-eight natural gasoline plants. In nearby States from which gas flows into some of the same interstate channels as gas produced in Oklahoma, there are many more thousands of wells productive of gas and more than two hundred natural gasoline plants.(10) The operations of the owners of these gasoline plants are typical "gathering" operations hereinabove described. The respective investments, values and rates of production of all of these producers and gatherers of gas are unlike, and the conditions and circumstances under which they operate are dissimilar. Even if it were not impossible for the Federal Power Commission to regulate the prices received for gas by these producers and gatherers on any basis whatever other than the whim or caprice of the Commission, the task of regulating the prices received by these producers and gatherers on any individual basis would be one to stagger the imagination: and cer-

10. 139 natural gasoline plants and 34 recycling plants in Texas, 27 natural gasoline plants and 4 recycling plants in Louisiana, 15 natural gasoline plants in Kansas, and 9 natural gasoline plants in New Mexico. See Oil and Gas Journal, April 20, 1946. For the purposes of this brief, the operation of recycling plants is substantially the same as that of natural gasoline plants as herein described.

tainly would be a far greater task than Congress could have contemplated. On the other hand, their investments, values, rates of production and operating conditions, as well as the types and qualities of gas which they deliver, and the pressures and conditions under which they deliver the gas, are so dissimilar that any regulation of their prices on a group or mass basis obviously would amount to discrimination and probable confiscation.

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**(3) In the great majority of cases it would be utterly impossible for the Federal Power Commission to fix such prices on any standard whatever other than the whim or caprice of the Commission.**

As we have previously indicated herein, in the State of Oklahoma, as in other nearby States in the Mid-Continent area, a tremendous volume of the natural gas which is produced, is produced in the form of "casinghead gas" from oil wells. The latest published statistics readily available[11] show that, as of the end of 1943, out of a total of 55,430 wells in the State of Oklahoma, 53,100 were oil wells which produced 163,000,000,000 cubic feet of casinghead gas, and 2,330 were gas wells which produced 161,000,000,000 cubic feet of gas well gas. In other nearby States the excess of the number of oil wells over the

11. United States Department of Interior, Bureau of Mines, Mineral Year Book 1944.

number of gas wells was even greater,[12] and while we have not undertaken to review the statistics further, it may be assumed that, in those States, the volumes of casinghead gas produced is equally as great a percentage of the total volumes of gas produced.

This casinghead gas is produced from the same formations from which the crude oil is produced and in the same producing operation as the crude oil.[13] The expansion of the gas acts as the driving force which drives the crude oil into the well bore and the production of the crude oil is completely dependent upon this force.[14] Conversely, the volume of casinghead gas produced and the resulting cost of production per unit of volume of gas are entirely dependent upon the volume of crude oil produced. This casinghead gas is usually rich in recoverable hydro-carbons extracted from the gas in the form of "natural gasoline," butane and other products. As we have mentioned before, this casinghead gas usually is "gathered" or collected through "gathering systems" to a central point or points where the recoverable products are removed in one or more "natural gasoline plants" and all of the remaining "residue gas" which is needed for the operation of the producing

12. Arkansas, 3,150 oil wells and 190 gas wells; Kansas, 23,100 oil wells and 1,990 gas wells; Louisiana, 7,250 oil wells and 1,790 gas wells; Mississippi, 370 oil wells and 20 gas wells; New Mexico, 3,980 oil wells and 120 gas wells; Texas 100,800 oil wells and 3,560 gas wells. See Mineral Year Book referred to in Footnote 11.

13. *Musselem* v. *Magnolia Petroleum Company*, 107 Okla. 183, 231 Pac. 526, and *Utilities Production Corp.* v. *Carter Oil Co.* (Circuit Court of Appeals, 10th Circuit, from Oklahoma), 72 Fed. (2d) 655.

14. Buckley & Leverett, "Mechanics of Fluid Displacement in Sands," Technical Paper 1337, A.I.M.M.E., 1941.

leases is returned through field pipe lines to such leases for that purpose.

As the science of production of oil and gas has progressed, it has been found that the recovery of crude oil can be increased by reinjecting some of this residue gas into the producing formations in operations known as "cycling" or "recycling" operations and, in fields where such operations are conducted, even greater volumes of residue gas are required for the development and operation of the leases.

However, in the great majority of cases, even where recycling operations are conducted, large volumes of residue gas are available for sale and are sold by the gasoline plant operators or by the producers at the outlet or exhaust of the natural gasoline plant at the point where the gathering operation ceases.

From the foregoing, it will be seen that the production of crude oil and the production of casinghead gas are so related that each is completely dependent upon the other, and it should be apparent at a glance that the cost, per unit of volume, of any residue gas from such casinghead gas which is available for sale and is sold, if such cost could be determined apart from the cost of the production of the crude oil, is dependent upon the volume of such gas returned to the leases and the volume remaining available for sale.

Presently, we shall point out why the relationship between the production of crude oil, natural gasoline and other products and the production of natural gas would, in the great majority of cases, make it utterly impossible

to apply any rate regulatory standards in the fixing of the prices received by producers and gatherers for such gas sold to interstate pipe line companies, but first we wish to show why, in any case, such standards would be completely inappropriate to the fixing of prices received by producers and gatherers for any natural gas sold to such pipe line companies.

One of the major services that the oil and gas industry performs for the public is the exploration for and development of new reserves. Producers in this industry must constantly search for new oil and gas reserves and must invest large sums of money in "wildcat" ventures. Necessarily many of the leases that are purchased are worthless and many of the exploratory wells are dry holes. The funds with which the industry performs this exploratory service must be derived from the sale of products by the industry, and the level of prices for those products necessarily must be high enough to provide those funds. Obviously, any rate base standard, whether "prudent investment" or "value" be the rate base, would be wholly inadequate to provide such prices. For example, a producer who makes a discovery of crude oil and natural gas or either of them in Oklahoma must recoup *from that successful venture* for his exploratory failures which may have been in some other State. The return which he must have to maintain his business is wholly unrelated to his investment in this successful venture alone, and no "prudent invest-

ment" rate base standard as applied to natural gas produced by him in Oklahoma could possibly provide for reimbursement to him of a part of his investment in other localities on any basis other than a purely arbitrary one which necessarily must predetermine the prices fixed in order to construct the rate base. The rate base standard with "value" as the rate base would be equally inadequate. As Mr. Justice Douglas has observed in the *Hope case*(15) and again in the *Canadian River case*,(16) value is the end product of the process of rate making, and not the starting point. The value of any article or thing, other than its sentimental value, is a reflection of its ability to produce revenue, and the control of the revenue necessarily includes the control of the value. This is particularly true of a gas lease, the value of which is entirely dependent upon the prices received for gas produced from the land covered by the lease. The regulation of prices received by producers and gatherers by the rate base standard with "value" as the rate base would inevitably result in reducing the value of the leases each successive time that the standard was employed.

However, as we have previously intimated, in the vast majority of cases the relationship between the production of crude oil, natural gasoline and other products and the production of natural gas would make it not only inappropriate but utterly impossible for the Federal Power

15. *Federal Power Commission* v. *Hope Natural Gas Company*, 320 U.S. 591, 88 L.ed. 333.

16. *Colorado Interstate Gas Co.* v. *Federal Power Commission*, and *Canadian River Gas Co.* v. *Federal Power Commission*, 324 U.S. 581, 89 L.ed. 1206.

Commission to fix the prices received in the field by producers and gatherers of gas for gas sold to interstate pipe line companies on any rate regulatory standard or on any standard whatever other than the whim or caprice of the Commission.

In the rate hearing *in re* Panhandle Eastern Pipe Line Company pursuant to which the Federal Power Commission regulated the rates of that company, (17) it was developed that one of the operations of Panhandle Eastern Pipe Line Company was the operation of a natural gasoline plant, located on its pipe line system, in which that company extracted from its gas natural gasoline which it sold in the open market. The prices for this natural gasoline were, of course, not subject to regulation and the treatment of the unregulated income from such natural gasoline presented a problem for the Commission which was disposed of by treating the operation of the gasoline plant as an incident to the operation of the pipe line system and the income from such natural gasoline as "incidental." (17)

Obviously, this treatment of this unregulated income resulted in the regulation of the total income of that company including this unregulated income, with the result that the amount of the total permitted income, exclusive of this unregulated income, was dependent upon the amount of the unregulated income. We offer here no criticism of the treatment in that case, but we wish to point out

17. *Panhandle Eastern Pipe Line Co. v. Federal Power Commission*, 324 U.S. 635, 89 L.ed. 1241.

that, in the case of a producer who produces casinghead gas from oil wells and in the case of the natural gasoline plant operator or a recycle operator, the income from such crude oil or from such natural gasoline is by no means "incidental" and such treatment of their income would be impossible. In the vast majority of cases, the income from the prices received for such crude oil or such natural gasoline far exceeds the value of the casinghead gas or the residue gas by whatever standard that value might be determined.

We believe that it requires no demonstration or argument that Congress did not, by the Natural Gas Act, undertake to vest in the Federal Power Commission any rate regulatory jurisdiction or any other jurisdiction over the production of crude oil, natural gasoline or other liquid hydrocarbon products produced and sold by the oil and gas industry or over the prices received therefor. But the fact that the Commission does not have control over the physical operations of a producer or a gasoline plant operator or recycle operator and does not have rate regulatory jurisdiction over the prices received for crude oil, natural gasoline or other liquid hydrocarbons, would make it impossible for the Federal Power Commission to make even a bare mathematical application of any rate regulatory standard, whether "prudent investment" or "value" be the rate base and, in fact, would make it utterly impossible for the Commission to fix the prices received by such producer or such gasoline plant operator or such recycle opera-

tor on any standard whatever other than the whim of the Commission.

Take the case of the producer who owns wells productive of both oil and casinghead gas. Having in mind that the level of prices in the oil and gas industry must be sufficient to support the exploration for new oil and gas reserves and that a producer must, from his "bonanza" or successful venture, recoup for his exploratory losses, it is to be expected that the "return" or revenue of this producer from crude oil alone may far exceed a rate of return on a "rate base" consisting of his productive wells and the leases on which they are located (whether investment or value be the rate base), of six and one-half per cent or any other rate which the Federal Power Commission or any other rate regulatory body would consider reasonable on utility standards. Obviously the Commission could not make him give away his gas and it is equally as obvious that, if his operations in the production of crude oil and gas should result in a loss, it could not allow him a price for his gas which would give him an over-all return of six and one-half per cent on either his total investment in, or the total value of, such properties. The only alternative for the application of a rate base standard would be some sort of allocation of the investment in, or cost of, his properties. The allocation would have to be either in the ratio of the volume of crude oil sold to the volume of gas sold or in the ratio of the respective incomes of these two products, but both of these ratios are subject to great fluctuation.

In order to operate his leases properly, the producer must retain the right to use all of the residue gas needed for such operations. In the case of repressuring operations, this may require all of the available residue gas and leave none for sale. Consequently, the ratio between volumes of crude oil sold and the volumes of natural gas sold would fluctuate from time to time; and the ratio between the respective incomes from the two products would be subject to even greater fluctuation for the reason that the income from crude oil is the result of a fluctuating market price. It is therefore clear that it would be impossible to make even a bare mathematical application of a rate base standard to the fixing of the prices received by such a producer for his gas.

As another example, take the case of the recycle operator (using that term to apply either to one operator or a group of operators operating a "unitized" field) who produces crude oil or "distillate" together with natural gas and conducts his operations by gathering the gas to a central point and returning a part of the gas, after processing it for the extraction of liquid hydrocarbons, to the producing formation in order to maintain the pressure and driving force in such formation, and who sells a part of the remaining or excess "residue gas." Obviously, such an operator is both a "producer" and a "gatherer" within the meaning of the Natural Gas Act. Here again, remembering that the successful operations must bear the burden of exploratory failures, it would be surprising if it should not

be found to be the case that, on rate regulatory standards, such operator's unregulated income from his sales of crude oil or distillate and other liquid hydrocarbons alone would result in a "return" on his "rate base" consisting of his properties in such field (and again regardless of whether investment or value be the rate base) far in excess of any return that the Commission or any other utility rate regulatory body would consider "reasonable" on utility standards. Certainly, in his case, the liquid hydrocarbons are no "by-product."

Again, it is obvious that the Commission could not, in such case, require such operator to give away his gas on the theory that his unregulated sales were already producing an excessive return on his investment in, or value of, his properties; and it is equally obvious that, in case he should be suffering a loss from his operations, the Commission could not make him whole by allowing him a high enough price on his gas to produce a "reasonable" return on his investment in, or the value of, his entire properties, even if he could get such a price from purchasers. And, here again, it would be utterly impossible to make any allocation, other than an arbitrary one, of his investment in, or the value of, his properties in order to arrive at a rate base. The prices for the crude oil or distillate and other liquid hydrocarbons are fluctuating prices and also, in order to operate the properties efficiently and without waste, the operator must retain control over the volume of gas to be recycled and the resulting volumes of "residue

gas" available for sale. So, in undertaking to fix the price received by such an operator for gas sold by him, the Commission would be met by the same necessity, as in the case of the producer referred to above, of making a purely arbitrary allocation of the cost or the value of such operator's properties in order to arrive at a rate base, and, therefore, the impossibility of fixing a price for the gas on a rate base standard.

The fixing of the prices received for gas by any natural gasoline plant operator by rate base standards would meet the same impossibility, regardless of whether or not recycle operations were being conducted. In view of the risk involved in the investment in such a venture it is to be expected that, in many cases, the income of the natural gasoline plant operator from the sale of natural gasoline and liquid hydrocarbons alone would greatly exceed a "return" on the investment in, or value of, such operator's facilities of six and one-half per cent or any other return which the Federal Power Commission or any other rate regulatory body would consider reasonable on utility standards, and, obviously, the Commission could neither require such a gasoline plant operator to give away his gas nor make any allocation of his investment in, or value of, his properties for rate base purposes other than a purely arbitrary one.

The only other standards which have been suggested for use by the Commission in regulating the rates of the natural gas companies are (1) the competitive field price,

and (2) the "functional test" suggested by Mr. Justice Jackson in the *Hope case*[18] and again in the *Canadian River case.*[19] It is clear that neither of these possible standards would offer any solution for the dilemma in which the Federal Power Commission would find itself in trying to regulate the prices received by the producer or the gasoline plant operator.

While the competitive field price would serve very well as a standard to gauge the allowance to be made to pipe line companies in respect of production from their own leases, it would be no standard at all by which to fix the prices received by producers and gatherers whose gas is sold to pipe line companies which transport and sell the gas in interstate commerce. This is for the reason that those producers and gatherers are, themselves, the principal competitors and the regulation of their prices would so narrow the field of competition that it would destroy the value of competitive price as a standard.

It is suggested by Mr. Justice Jackson that, by a "functional test," an incentive or inducement could be offered to the producers to direct their gas into proper channels. In view of the fact that, in order to protect its tremendous investment, a pipe line company must, before construction of its line, be assured of supplies of gas by procuring purchase contracts which extend for some years,

18. *Federal Power Commission* v. *Hope Natural Gas Company*, 320 U.S. 591, 88 L.ed. 333.

19. *Colorado Interstate Gas Co.* v. *Federal Power Commission* and *Canadian River Gas Co.* v. *Federal Power Commission*, 324 U.S. 581, 89 L.ed. 1206.

it is difficult to see how the Federal Power Commission could, through the medium of price fixing, offer any inducement to producers without approving contract prices established before the construction of the pipe line, which would be a strange procedure in the field of rate regulation.

But, aside from that consideration, the suggested "functional test" would be completely inapplicable for the fixing of prices received for gas by a producer who owns wells productive of both crude oil and casinghead gas or by the owner of a gasoline plant. The producer and this gasoline plant operator are alike in one respect. They must retain a substantial measure of control over the volume of gas delivered. The requirements for gas for use as fuel in the operation of the producing properties may vary from time to time and may even consume all of the available gas. Neither can know in advance exactly how much gas he will be able to sell to a given pipe line company at any given time. In the case of the gasoline plant operator, both the volume and the quality of the gas delivered to the pipe line company may depend, to a substantial measure, upon the extent of the extraction of liquid hydrocarbons from the gas. The extent of the extraction of liquid hydrocarbons affects materially the value of the gas to the pipe line company and, conversely, the price received by the plant operator has a direct bearing upon the volume of liquid hydrocarbons he will extract.

Gas is sold by such producers and such gasoline plant operators under a wide variety of circumstances and con-

ditions. It may be sold at the well or it may be sold at a central delivery point. In either case, it may be sold at pressures ranging from atmosphere up to hundreds of pounds per square inch and the cost of delivery will vary with the pressure at which the gas is delivered. It may be "sweet" or it may be "sour" with widely varying sulphur content. If the gas, when produced, is sour, the seller may or may not treat it for the removal of sulphur depending upon his contract with the buyer. The value of gas for resale purposes may depend upon its heating value and the heating value of the gas delivered at different points may vary several hundred B.T.U.s per cubic foot.

The Commission clearly does not, under the Natural Gas Act, have control over the physical acts of producing and gathering gas in the field. The Commission could not control the volumes of gas to be delivered by a producer or gasoline plant operator, the pressures at which it is delivered, the extent to which liquid hydrocarbons shall be extracted before delivery of the gas, nor the extent to which either the producer or gasoline plant operator must risk his capital in development or construction of facilities. If it had jurisdiction over the prices received by them for gas, it could consider all of these circumstances only as factors in determining the price to be paid for gas.

But the value of the gas is determined by still another factor, namely, competition among the sellers. The price that a producer or gatherer can obtain for gas from a pipe line company is limited by the prices at which other pro-

ducers and gatherers in the same field or in other fields are willing to sell gas to the same pipe line company. If the Commission had rate regulatory jurisdiction over the prices received by producers and gatherers for gas sold to interstate pipe line companies, it could not set the price to be paid to any particular producer or gatherer too low without forcing that producer or gatherer to use the gas in his own operations or to extract greater quantities of liquid hydrocarbons from the gas and thus reduce the quality of the gas; or to decline to risk his capital on further development or improvements while, on the other hand, it could not require the pipe line company to pay a higher price than the competitive prices at which other producers and gatherers in the same area would be willing to sell their gas.

In other words, if the Commission had rate regulatory jurisdiction over the prices received by producers and gatherers for gas sold to interstate pipe line companies, it would be bound by the same forces which fix competitive field prices and any attempt to fix such prices could be nothing more than an attempt to ascertain the competitive field prices.

As a matter of fact, the only reason that it was possible for the Federal Power Commission to apply its "prudent investment" rate base standard to the operations of Interstate Natural Gas Company, Incorporated, in this case was the fact that that company had no wells in the Monroe field productive of crude oil and no gasoline plant

in which it extracted natural gasoline from the gas sold by it to the three pipe line companies.

The operations of Interstate Natural Gas Company, Incorporated, involved in this case were *unique* in this respect. It is a rare circumstance in the Mid-Continent area for the production and gathering of gas to be unaccompanied by either the production of crude oil or the operation of a recycling plant or a natural gasoline plant. As we have previously observed, there are in the Mid-Continent area far more wells productive of natural gas with oil than there are wells productive of natural gas only. In addition, in the Gulf Coast section of the Mid-Continent area there are many "distillate fields" in which the gas is gathered to a central point and processed in a "recycling plant" after which a part or all of the gas is returned to the producing formations; and even in the cases where gas alone is produced, the gas usually contains sufficient quantities of hydrocarbons which can be removed and sold in liquid form that the operation of a gasoline plant for the removal of such hydrocarbons is usually an integral part of the production and gathering of such gas.

In the opinion of the State, all of the foregoing discussion in this section of the brief is merely an illustration that the production and sale of natural gas in the field by producers and gatherers thereof is an integral part of the operations of the highly competitive oil and gas industry which cannot be separated or segregated from the other operations of that industry and that Congress could not

have intended by the Natural Gas Act to substitute rate regulatory standards for the functions of competition in respect of such a small and inseparable segment of the operations of that industry.

The foregoing discussion of the factors and conditions which must have necessarily been considered by the Congress, clearly demonstrate why the Congress was impelled to exclude the production and gathering of natural gas from the jurisdiction conferred upon the Federal Power Commission. Aside from all the extraneous aids in construing the Act, it seems quite clear to the State of Oklahoma that the language employed by the Congress is not reasonably susceptible of the construction now placed thereon.

Reverting to the legislative history of the enactment of the Natural Gas Act, it is found that this conclusion is supported by the reaction and statement of the persons closely connected with the drafting and passage of this legislation. In *Colorado Interstate Gas Company* v. *Federal Power Commission*, 324 U.S. 581, Mr. Chief Justice Stone, Mr. Justice Roberts, Mr. Justice Reed, and Mr. Justice Frankfurter stated that the exemption of the production of natural gas from regulation excluded the power to fix the price of gas in the producing field. They further said:

> "The exclusion of production and gathering of natural gas from the regulatory authority of the Commission is a command to the Commission not to regulate that which is excluded. Otherwise powers

reserved to the State would be encroached upon, contrary to the word and purpose of the Act, and a pretended government would be set up by the Commission's action, without the authority of Congress." (89 L.ed. 1232-1233.)

Mr. Justice Jackson concurred in the majority opinion in said case, but stated that he would join in holding that an order of the Federal Power Commission which would have an immediate impact upon the production or gathering of gas to be beyond the jurisdiction of the Federal Power Commission. He further stated that he construed the majority opinion in which he concurred as only authorizing the Federal Power Commission to take evidence as to conditions and events quite beyond its regulatory jurisdiction where they are thought to affect the cost of that which clearly must be regulated by the Federal Power Commission.

In the instant case, the Federal Power Commission has attempted to enter an order having a direct impact upon the gathering and production of gas: namely, the price which may be charged by the producer and gatherer to companies which engage in the subsequent transportation and sale in interstate commerce. It is difficult to conceive how any order of the Federal Power Commission could have a more direct impact upon any phase of the natural gas industry than the present order has upon the "gathering and production" of natural gas. Thus under the literal language of the Act as construed by five Justices of this Court, the production and gathering of gas includes

the field sales of such gas, and field sales of such gas to companies which subsequently transport and sell same in interstate commerce are not subject to the regulatory power of the Federal Power Commission.

## CONCLUSION

From the foregoing discussion it should be clear (1) that an interpretation of the Natural Gas Act to mean that Congress intended to leave in the producing States control over the physical operations of the producers and gatherers and at the same time to vest in the Federal Power Commission rate regulatory jurisdiction over the prices received by producers and gatherers for gas sold to pipe line companies which transport and sell the gas in interstate commerce would, in fact, deprive the producing States of the power to conserve their oil and gas resources and to protect the correlative rights of owners thereof and would result in an intolerable conflict of jurisdiction; (2) that any attempt to regulate individually the prices received by the thousands of producers and the hundreds of natural gasoline plant operators whose gas is or may be sold to pipe line companies which transport and sell the gas in interstate commerce would be a colossal undertaking for which no adequate provision was made by Congress and any regulation of their prices on a group or mass basis would amount to discrimination and probable confiscation; and (3) that, in the vast majority of cases, it would be utterly impossible for the Federal Power Commission to regulate the prices

received by such producers and gatherers on any standard whatever other than the Commission's whim or caprice.

It cannot be assumed that Congress deliberately intended to produce an intolerable conflict between the States and a Federal regulatory body or that it intended to do a vain or absurd or impossible thing. It therefore must be assumed that Congress intended that the prices received by producers and gatherers of gas should continue to be fixed in a manner consistent with our national economy, that is, by competition within the highly competitive oil and gas industry.

For the foregoing reasons, it is respectfully submitted that the petition of the Petitioner, Interstate Natural Gas Company, Incorporated, for relief herein should be granted.

THE STATE OF OKLAHOMA,
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